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Economic Conditions Governmental Finance United States Securities

New York, November, 1936

General Business Conditions

TRADE and industrial news has continued favorable during October. Notwithstanding the preoccupation with the Presidential campaign, it is evident that business has suffered no interruption; nor have opinions as to the outlook, for the near future at least, been altered. Both the markets and trade reports indicate that good business is expected during the remainder of the year.

At the beginning of the month fears were expressed in some quarters that the devaluation of the Gold Bloc currencies might disturb security prices in this country, and possibly lead to an export movement of gold. The amount of European funds invested in the United States is abnormally large, and no one would have been greatly surprised if after their devaluation the French, Dutch and others had sold American securities in order to take their capital back home. But if foreign selling has taken place it has been insignificant in the general situation. Securities markets are higher than before the devaluations, and gold exports have not materialized; on the contrary the gold movement has continued, on balance, in this direction. It is plain that European investors still consider the opportunities in this country attractive. Moreover, the successful co-operation of the three Governments in forestalling a new cycle of currency depreciation has led to a bullish interpretation of the important developments which have taken place, and which are discussed subsequently in this Letter.

In the trade situation, merchandise sales have shown steady and satisfactory increases over a year ago. Final retail figures for September were better than preliminary estimates, with department store sales 14 per cent over 1935, and chain stores and mail order houses up 18. October gains have been good also. Many merchants are of the opinion that the trade and price outlook, and the possibility of trouble in obtaining prompt deliveries in some goods, justify more liberal forward buying; and forward operations have been active in cotton goods, certain household and industrial supplies, and in some heavier industries where possible wage or price increases provide an inducement to buy ahead. Hence industries have good backlogs of orders, prices of manufactured goods are firm, and factory operations are expected to continue at a good rate.

Automobile Manufacturers Optimistic

The automobile industry is decidedly confident. Assemblies of new models are now under way in practically all factories, and are increasing steadily from week to week. A production of 400,000 cars in November is looked for. The new cars are improved over last year's models, and offered in many cases at lower prices, setting once more an example of progress for all the industries. Orders from dealers are reported well ahead of last Fall. A corresponding gain in retail sales is everywhere expected, and if this is realized the industry will contribute even greater support to general business than it did a year ago, when its buying of parts and materials was the chief influence in the upswing.

Steel mill operations are being supported to an important extent by automobile orders, sheet mills being fully booked up; this tends to offset the seasonal drop in structural steel buying and some other divisions. Steel ingot production continues to run not much below 75 per cent of capacity.

The outlook in the capital goods industries is for further improvement, after possibly some seasonal moderation in building and associated industries. Although in some cases consideration of projects for plant expansion and improvement has been held over until after election, there are impressive instances of willingness to go ahead with plans of this kind. Foremost among those announced during October is the decision of the United States Steel Corporation to carry out a construction program at Birmingham, including a tin plate mill, the first in the South, at a total cost of $29,000,000. This is part of the rehabilitation and ex-

pansion program of the Corporation, and in announcing it Mr. Myron C. Taylor, the Chairman, emphasized the enormous unsatisfied needs which must be supplied in all lines, and his conviction that the recovery movement is still far from complete. Another important move by the Steel Corporation is the resumption of full dividend payments on the preferred stock, which in view of the position of leadership held by this great organization is a landmark in the recovery.

All these influences have tended to maintain business confidence. Moreover, corporation earnings during the third quarter, as now reported, continued to gain. The compilations of this Bank, published on page 156, show an increase of 59 per cent over a year ago, for manufacturing and trading corporations. With factory wage payments continuing heavy, a good farm income, increased corporation disbursements, and the now accustomed flow of Government funds, consumers will have a satisfactory purchasing power for the holiday trade. There is no lack of prediction that Christmas retail sales will be the best since 1929, and many merchants are making their preparations upon that basis.

Covering Forward Requirements

This general summary of the business news makes cheerful reading, and it seems unquestionably true that business activity has reached a new high point for the recovery. Naturally some are asking whether the movement is not going too fast, and whether stocks of goods are not being accumulated, at the expense of a slowing down of production in the first half of next year. It is recognized that wants are still unsatisfied and labor and plants still unemployed, and thus there is no limit to the recovery as long as all the elements in it are kept in balance, costs and prices remain in line with purchasing power, and maladjustments of production and consumption are avoided in each industry. However, few business upswings run long without such maladjustments appearing, which require a pause for their correction and interrupt the forward movement temporarily, even though the force of recovery is far from exhausted.

The appearance in some merchandise lines of premiums for spot goods, and the reports that business men are increasingly buying ahead or carrying larger inventories, are manifestly important developments. Premiums for nearby deliveries are evidence of strong demand and a high rate of consumption, but when buyers begin to compete in this way, and to expand their coverage against future needs, orders in the markets may temporarily become larger than consumption warrants, and an appearance of scarcity may be created which is more illusory than real. Experienced observers recognize that when this type of buying appears business is more likely than not to be nearing the top of an upward movement, and ready for a tapering off while the accumulated purchases are absorbed. This view of the matter inspires caution, as possibly suggesting a resting period in the recovery some time in 1937.

On the other hand, there is obviously no way of determining when a policy of buying ahead, once begun, will stop. In some cases the buying is a precaution against inability to obtain goods when needed, and a resulting price "squeeze." If buyers are of the opinion that a change to a sellers' market is taking place in important lines the move may go a long way, and last a long time. In the recovery thus far the supply of manufactured goods has kept abreast of the demand without much difficulty, and only in negligible instances has anything like a sellers' market appeared. However, as business improves and demand rises the efficient low-cost capacity of many industries will gradually be worked to the limit; and from that point increases in demand will disclose a scarcity and advance prices until high-cost plants can operate profitably, or new low-cost plants be made ready. At some stage of the recovery this will happen, of course at different times in different industries.

Some Industries Reaching Practical Capacity?

Considering the situation as a whole, it is plain that no general change to a sellers' market is to be apprehended. The business recovery has retraced only three-fourths of the ground lost from the 1929 peak to the 1932 bottom, and the unemployment is all the evidence needed that the productive facilities of the country are working below their possibilities. It is hardly conceivable that a scarcity of goods can develop which will not be quickly relieved, either through increased output or because the buying turns out to be running ahead of consumption.

However, a temporary or seeming scarcity in certain lines is not particularly surprising. The depression made inroads on the capacity of many industries, for factories and mines have been closed and the equipment of others has depreciated or become obsolete; and there are expanding industries, rayon being an example, whose sales have grown more rapidly than new plants have been built.

Moreover, the practical question is not as to the capacity when all plants are operating full, but at what level they can operate under existing conditions. In some cases there are indications that shortage of skilled labor is limiting production, and in others there is fear that labor troubles will interrupt operations.

In holiday merchandise lines warnings are being offered that the delays now experienced in getting delivery will become more acute

before Christmas, and that late re-orders will be impossible to fill. The National Association of Purchasing Agents reports delivery difficulties in a number of heavy products. It is common knowledge that deliveries of machine tools, heavy electrical equipment and some other types of machinery are delayed.

Coal and the Metals

During the past month, when railway traffic has been as usual at the seasonal peak, temporary shortages of special types of cars have been reported. The situation has not been at all serious, but Railway Age refers to it as "the first car shortage since 1923," and estimates that the roads will need to buy 150,000 cars within the next twelve months. Slight as the shortage was, it has been a factor stiffening bituminous coal prices. The coal trade reviews say the capacity of many mines in Pennsylvania and West Virginia is being taxed, and refer to car shortages at times as limiting production. However, the car supply will again be ample when the ore movement ends and ore cars are released for coal. The bituminous situation is a sound one, stocks held by large users being small.

The steel situation is of great interest. As already noted steel operations are holding close to 75 per cent of capacity. Sheet mills and some others are booked to the end of the year, and ingot production for the full year 1936 will be within 17 per cent of the 1929 peak. This is a striking showing in comparison with the fact that structural steel business is not much over half the 1929 level, and railway orders only about a third. Although some other users of steel are taking more than in 1929, the question naturally arises whether production is not outrunning consumption, and steel being accumulated against 1937 needs. The inducement to forward buying is recognized; it is generally believed that steel wages will be raised and prices also, and if this happens orders will take another spurt, but a later recession would be expected. Meanwhile furnaces idle for a long time are being brought back into use, and there will be no shortage of steel unless labor difficulties restrict production.

With forward buying active, copper has been marked up to 10 cents in the domestic markets, the third advance this year. The statistical position has improved for two years, and visible stocks in this country at the end of September represented only 2½ months' supply, compared with 8 months' at the beginning of 1935. To be sure, part of this drop may be offset by increased stocks in the hands of fabricators and consumers. The domestic situation is very satisfactory, but of course there is no strain on production capacity, since restriction is still practiced. Doubtless the policy of the copper companies will be to increase their output as consumption expands, rather than to discourage the improvement through higher prices.

A Cotton Goods Boom

The cotton goods industry is one in which forward business, in unfinished goods especially, has reached an enormous volume. Premiums on spot goods are the rule, and after the heavy buying during October many mills are sold up far into the first quarter of 1937.

The idea that cotton goods production is approaching its practical capacity will be a novelty to many people, accustomed to think in terms of the three-shift operations which formerly prevailed, but which are now exceptional, and accustomed also to hear the troubles of the industry attributed to overcapacity. However, a prominent Southern manufacturer, Mr. W. D. Anderson, chairman of the Bibb Manufacturing Co., has written a letter to his customers from which the following paragraph is extracted:

> We are rapidly approaching the reasonable limits of supply of cotton textiles, since most of the spindles now active are operating to full capacity. While there are several million spindles in place that are not active today, there will have to be a big improvement in the margin or spread between cost of cotton and selling price of goods before these inefficient, not to say obsolete, spindles are started up. It is more likely that most of them will, within the next few years, go on the junk pile, where they belong. The day of the operation of worn-out and obsolete machinery is past.

Figures pertinent to Mr. Anderson's argument are given in monthly reports of spinning activity issued by the Department of Commerce. They show that on September 30 the number of spindles in place was 27,962,666, a drop of nearly 10,000,000 from the peak about ten years ago, while the number operated during the month was 23,514,270. This is lower than the monthly average of each of the past ten years, except 1932 and 1935.

Cotton consumption in September, however, was the largest for the month on record, and since the industry is freely competitive and anxious for all the business it can get, operations are likely to run high enough to catch up with the scarcity of spot goods. There is room to increase the hours worked per spindle, although the labor supply and other considerations will enter.

Raw Material Prices

In addition to delivery difficulties, another inducement to forward buying is an upward trend in raw material prices which is being communicated to manufactured goods. As a general statement, there are plainly limitations on raw material price advances; production of most of these commodities is decidedly below capacity, being curtailed either by production controls, as in rubber, copper and other products, or by temporary conditions such as the effect of drouth on agricultural production.

The tendency of price advances is to cause producers to relax their controls, and to stimulate output. If 1937 is a good crop year probably the advancing trend of farm prices will receive a check, since the acreages planted will be large. Also some of the producers in the control schemes, at present prices, would rather expand their output than force a further price advance. The copper producers are doing so.

Need for More Capital Investment

For the reasons given, it is our view that the situation described is less a threat of scarcity, sellers' markets and rapid price advances, than a reassuring indication of better business ahead for the capital goods industries. It is a warning that much work remains to be done in bringing the industrial plant up to date, in replacing machinery and training labor, and that the country ought to get ahead with it before real shortages appear.

An excessive rise of the price level due to scarcity would be a menace. The danger may not be apparent to those who seemingly benefit; nevertheless scarcity is a characteristic of an unhealthy boom and not of prosperity. A healthy business requires a production equal to all needs, and a moderate excess of productive capacity is the best assurance that efficiency will be maintained, costs controlled, and goods marketed at prices which will sell them. All these are essential to prosperity.

It is in order to add that Government policies to encourage rather than penalize savings and capital expenditures would be of great help in relieving all danger of underproduction. Anything which upsets the balance, such as discouragement of capital investment upon the mistaken arguments of over-capacity and concentration of wealth, interferes with the abundant and widespread distribution of goods and services, which is the aim of all business.

If delayed deliveries and similar difficulties supply a fresh impulse to new investment and improvement of the industrial plant, the capital goods industries should go ahead more strongly in 1937. Bringing new capacity into production would let the wind out of the incipient boom in some lines, and perhaps slow them down temporarily while stocks accumulated for fear of scarcity were absorbed. However, the situation in the long run would benefit. Sellers' markets and a great surplus of unemployed labor are unnatural companions. The need is to keep costs and prices down, increase production, and get people back to work.

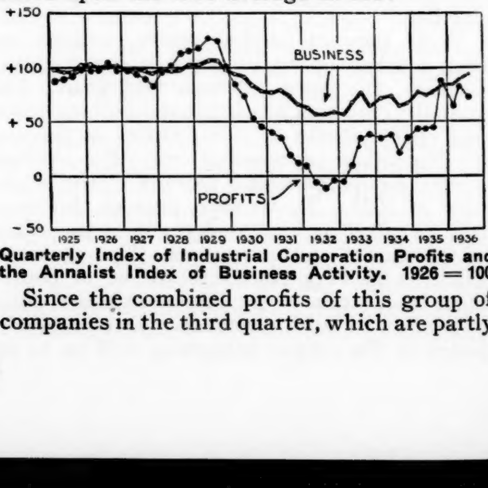
Moreover, in view of the credit expansion which could take place upon the banking reserves now accumulated in this country, the danger that will threaten if an upward price movement gets under way rapidly will be greater than any ever before known. Those who are co-operating in restriction schemes, or sponsoring the philosophy of restriction, should consider this side of the matter.

Third Quarter Profits

The continued rise of activity in important lines of industry and trade in the third quarter of the year has been reflected in increased profits reported by many corporations that have published earnings statements during the past month. Numerous railroad, electric power, gas, telephone and other public utility companies also made an improved showing as to both gross and net income.

A tabulation of the reports of some 245 leading manufacturing and trading companies shows combined net profits, less deficits, of approximately $265,000,000 in the third quarter of this year, as compared with $317,000,000 for the same companies in the preceding quarter and with $167,000,000 in the third quarter of last year. The percentage gain over last year was 58.7 per cent in the third quarter, and was higher than the gain of 42.3 per cent reported for a similar group of companies in the first quarter, but less than the gain of 73.8 per cent reported in the second quarter. In judging these percentage gains, it must be borne in mind that they are measured from a relatively low base,—one which is still considerably below pre-depression levels. When business recovers from a period of slump, it is to be expected that profits will rise faster than production and employment, for the reason that profits represent the marginal figure between gross income and costs of operation. In periods of declining business, profits tend to fall much more rapidly than production and employment and in many cases not only disappear altogether but are converted into heavy deficits.

The trend of quarterly profits of industrial corporations over a period of years is shown in the accompanying chart, giving an index computed from the rate of profits return on net worth of 200 leading corporations, corrected for seasonal variation, and giving also the Annalist Index of Business Activity, both based upon the 1926 average as 100:



Quarterly Index of Industrial Corporation Profits and the Annalist Index of Business Activity. 1926 = 100

Since the combined profits of this group of companies in the third quarter, which are partly

estimated, decreased from the second quarter somewhat more than the normal seasonal extent, the adjusted index declined slightly and stood at about 72 per cent of the 1926 average level.

Results for the Nine Months

The accompanying summary of the 245 companies, whose quarterly figures have already been given, shows that for the first nine months of this year their combined net profits, less deficits, amounted to approximately $792,000,000, as compared with $485,000,000 for the same companies in the corresponding period of a year ago, representing an increase of 63.3 per cent. These companies had an aggregate net worth of $10,368,000,000 at the beginning of the year, upon which the nine months profits were at the annual rate of return of 10.1 per cent this year as compared with 6.1 per cent a year ago.

As has been repeatedly pointed out in connection with these tabulations, the published reports of a limited group of leading corporations merely indicate the *trend* of profits, and do not provide an accurate measure of average earnings of all corporations, which are always much lower.*

*Condensed summaries of the income of all corporations in the United States over a period of years, compiled from the annual Treasury Department "Statistics of Income", have been given in the following issues of the Bank Letter: All Manufacturing Corporations—March, 1936; All Merchandising Corporations—September, 1936; All Corporations Reporting—April, 1936.

It is important to note also that although most of the companies that have published earnings reports for the third quarter and the first nine months of 1936 made provision for the ordinary federal income taxes, they have not attempted to set up reserves for the new surtaxes on undistributed income imposed by the Revenue Act of 1936, since the liability for this tax cannot be determined accurately until after the close of the fiscal year. To the extent that no provision can be made for these surtaxes, the reported earnings after charges are overstated this year.

The pressure of the new taxes to force the disbursement of corporate earnings, together with the gain in the earnings themselves, have been reflected in a heavy increase in dividends this year, the compilation of the New York Times showing an increase in dividend declarations publicly reported during the first nine months of 24.2 per cent over those of the same period last year, and an increase of 32.7 per cent in the third quarter.

Gains in Sales and Profits

Sharp gains in profits for the nine months, accompanied by marked increases in volume of business, were reported by numerous companies in such industries as automobiles and accessories, iron and steel, electrical, railway and other machinery, office equipment, building materials, chemicals, paper and petroleum. Sizeable increases, however, were also re-

INDUSTRIAL CORPORATION PROFITS FOR FIRST NINE MONTHS

Net Profits Are Shown After Depreciation, Interest, Ordinary Taxes, and Other Charges and Reserves, but Before Dividends.

Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industry	Net Profits Nine Months 1935	1936	Per Cent Change	Net Worth January 1 1935	1936	Per Cent Change	Annual Rate of Return 1935	1936
1	Autos—General Motors	$114,483	$175,199	+ 53.0	$872,485	$930,667	+ 6.6	17.4	25.0
7	Autos—Other	21,152	40,295	+ 90.5	175,230	200,864	+14.6	15.9	26.6
16	Auto Accessories	15,412	20,336	+ 31.9	132,230	143,238	+ 8.2	15.4	18.7
5	Aviation	2,242	3,904	+ 74.1	66,926	70,658	+ 5.5	4.3	7.3
5	Baking	11,479	16,082	+ 40.0	217,545	217,717	+	6.9	9.7
15	Building Materials	12,603	20,742	+ 64.5	247,352	251,922	+ 1.8	6.6	10.9
11	Chemicals	74,009	108,028	+ 45.9	956,557	976,739	+ 2.1	10.2	14.6
8	Coal Mining	1,241	750	— 39.5	83,762	77,013	— 8.0	1.8	1.1
5	Drugs and Sundries	2,395	3,725	+ 55.5	58,979	60,038	+ 1.7	5.3	8.2
8	Electrical Equipment	29,015	45,124	+ 55.5	592,216	605,807	+ 2.2	6.3	9.8
14	Food Products—Misc.	47,084	61,552	+ 30.7	545,625	551,471	+ 1.0	11.4	14.7
11	Household Goods and Sup.	17,410	22,168	+ 27.3	190,740	191,543	+ 0.4	12.1	15.2
1	Iron and Steel—U. S. Steel	D-4,241	29,875	+	1,840,532	1,564,373	—15.0	......	2.5
14	Iron and Steel—Other	16,428	38,367	+133.5	1,238,763	1,250,032	+ 0.9	1.7	3.9
5	Liquors	10,605	10,501	— 1.0	70,061	79,302	+13.1	20.0	17.5
14	Machinery	6,819	15,825	+132.1	151,573	142,125	— 6.2	5.8	14.7
5	Merchandising	2,270	4,517	+ 98.9	45,554	53,240	+16.8	6.5	11.1
9	Mining, Non-ferrous	40,408*	51,985*	+ 28.6	847,076	872,689	+ 3.0	6.2	7.8
6	Office Equipment	10,031	12,778	+ 27.3	120,829	120,491	— 0.4	11.0	14.0
8	Paper Products	D-582	5,144	+	209,305	209,279	—	......	3.1
14	Petroleum	22,832	50,289	+120.2	780,609	812,137	+ 4.0	3.8	8.1
7	Railway Equipment	2,273	10,721	+371.6	402,137	386,790	— 3.8	0.6	3.5
9	Textiles and Apparel	4,467	7,172	+ 60.5	59,253	62,771	+ 5.9	9.9	15.1
5	Tobacco (Cigars)	2,684	2,854	+ 6.2	50,895	52,645	+ 3.4	6.9	7.1
24	Miscel. Manufacturing	18,016	25,200	+ 39.8	223,546	234,510	+ 4.9	10.6	14.2
18	Miscel. Services	4,563	9,154	+100.6	252,242	250,268	— 0.7	2.3	4.7
245	Total	$485,098	$792,287	+ 63.3	$10,432,022	$10,368,329	— 0.6	6.1	10.1

D—Deficit. *Before certain charges.

ported by many companies in other industries, in which volume has been relatively well maintained, such as baking and miscellaneous food products, drugs, household equipment, nonferrous metals, textiles and apparel.

Although sales figures are given only by a comparatively small number of the companies that issue interim reports on earnings, the accompanying table listing the figures made available by some of the more important companies in various lines of manufacturing and merchandising will indicate the expansion in business volume that took place during the nine months period.

Per Cent Change in Nine Months Sales, 1935-1936

Manufacturing		Merchandising	
Air Reduction Co.	+36.7	American Stores Co.	— 2.6
Allis-Chalmers Mfg.	+60.6	Barker Bros. Corp.	+30.0
Amer. Colortype Co.	+18.8	Consol. Retail Stores	+ 9.8
Amer. Radiator Co.	+25.3	Edison Bros. Stores	+21.5
Amer. Writing Paper	+11.0	Fanny Farmer Candy	+15.4
Atlas Powder Co.	+22.6	W. T. Grant Co.	+ 4.9
Baldwin Locomotive	+ 1.4	H. L. Green Co.	+13.6
Caterpillar Tractor	+52.3	Interstate Dept. Strs.	+18.1
Cooper-Bessemer Corp.	+142.4	Jewel Tea Company	+ 6.9
Flintkote Company	+24.3	S. S. Kresge Co.	+ 7.0
General Electric Co.	+26.8	S. H. Kress & Co.	+12.0
General Motors Corp.	+28.5	Kroger Groc. & Bak.	+ 2.6
Hercules Powder Co.	+19.7	Lane Bryant, Inc.	+ 7.7
Interlake Iron Corp.	+26.0	Lerner Stores Corp.	+15.4
Inter. Printing Ink	+19.8	McCrory Stores Corp.	+ 8.4
Johns-Manville Corp.	+39.6	McLellan Stores Corp.	+ 8.3
Link-Belt Company	+45.0	Melville Shoe Corp.	+15.9
Lone Star Cement	+28.0	Montgomery Ward	+20.1
Kimberly-Clark Corp.	+12.2	G. C. Murphy Co.	+19.0
McKesson & Robbins	+13.9	National Tea Co.	+ 0.5
Maytag Company	+ 1.0	Neisner Bros., Inc.	+13.4
Mead Corporation	+22.5	J. J. Newberry Co.	+11.0
Mengel Company	+40.2	J. C. Penney Co.	+14.1
Mid-Continent Petrol.	+18.7	Peoples Drug Stores	+ 8.9
Minn.-Honeywell Reg.	+47.2	Safeway Stores, Inc.	+17.4
Natl. Cash Register	+23.8	Schiff Company	+ 9.8
Otis Elevator Co.	+36.9	Sears, Roebuck & Co.	+25.4
Remington-Rand, Inc.	+23.4	Spencer Chain Stores	+ 5.3
Ruberoid Company	+24.7	Spiegel, May, Stern	+26.3
Scott Paper Co.	+14.0	Sterchi Brothers	+19.6
Seaboard Oil Co.	+43.1	Sun Ray Drug Co.	+40.1
Shell Union Oil	+10.8	John R. Thompson	+ 5.4
Superior Steel Corp.	+59.5	Waldorf System	+11.1
Thatcher Mfg. Co.	+45.9	Walgreen Company	+ 7.6
Union Oil Company	+15.3	Western Auto Supply	+22.6
U. S. Hoffman Machy.	+34.2	F. W. Woolworth Co.	+ 6.5
Westinghouse Elec.	+26.0		
Wheeling Steel Corp.	+17.4		

Railroads and Other Utilities

There has been a decided upward trend in railroad freight and passenger traffic this year, and a substantial portion of the increase in gross revenues has been carried over into net income, despite the increase in operating expenses and taxes, including the new taxes imposed under the Railroad Retirement Act and the Social Security Act. An examination of the following statistics by three months periods of all Class I steam railroads, with the third quarter partly estimated, will show the progressive improvement that has taken place.

It is now expected, on the basis of actual results thus far, that for the full year the net income after taxes and interest of all Class I railroads combined will be at least $100,000,000, and that this year will be the first since 1931 in which fixed charges have been fully

All Class I Railroads in the United States
(In Millions of Dollars)

	1935	1936	% Change
Gross Revenue			
First quarter	$800	$ 908	+13.5
Second quarter	836	965	+15.4
Third quarter	876	1,058*	+20.8
Nine months	2,512	2,931*	+16.7
Net Operating Income			
First quarter	86	105	+22.0
Second quarter	109	134	+22.9
Third quarter	127	197*	+55.2
Nine months	322	435*	+35.0
Net Income after Charges			
First quarter	D-45	D-28	+ ....
Second quarter	D-18	5	+ ....
Third quarter	D- 5	64*	+ ....
Nine months	D-67	40*	+ ....

* Third quarter of 1936 partly estimated.
D- Deficit.

covered. A net income of this amount, however, would represent an average return of only 7/10 of one per cent upon the railroad shareholders' equity of approximately $12,000,000,000, and many individual systems will fall short of earning their fixed charges. As some 75,000 miles, or 30 per cent of the entire railway mileage of the country, is in receivership, trusteeship or reorganization, with part of the remaining mileage covering charges only by narrow margins, it is clear that the current uptrend in earnings must be carried a great deal further before the railroad structure as a whole is restored to a reasonably profitable condition.

A list of 25 representative public utility systems supplying electric power and light, gas and other services, shows for the twelve months ended September 30 an increase of 3.0 per cent in gross revenues, and an increase of 9.8 per cent in net income. The American Telephone & Telegraph Company and associated operating companies had an increase of about 7.7 per cent in total revenues during the same period, and an increase of 22.3 per cent in net income of the parent company.

Money and Banking

Reference has been made in our leading article to the failure of the devaluation of the Gold Bloc currencies to justify the apprehensions of those who feared a sudden withdrawal of European capital, with disturbing effects upon our markets.

Apparently London, which has become the repository of large amounts of Continental capital during the long struggle to maintain the Gold Bloc currencies, has experienced some outflow of funds, but the movement has been in no way burdensome and interest rates have remained unaffected. Gold holdings of the Bank of France increased by 14,247,000,000 francs during the four weeks ended October 23, indicative of some repatriation of capital

and dehoarding of metal in France; also, a decline in the outstanding notes of the Bank of England since devaluation appeared to be further evidence of dehoarding, since these notes were purchased widely on the Continent as a hedge against currency depreciation. At New York, approximately $10,000,000 of gold was reported earmarked for foreign account on the 17th, presumably a reflection of exchange operations in support of the dollar. However, this is a negligible sum compared with the enormous resources of the market. Moreover, the United States also has imported gold during the month, and the net result of all movements was a further gain in our total gold stock.

Late in the month sentiment seemed to change, and a fresh drive against the franc, necessitating intervention by the official control funds, emphasized anew the continued instability of the situation.

Of course, capital may still flow from this market, particularly if economic and political conditions in Europe improve. When the dollar was devalued the return of expatriated American capital did not commence until after the dollar was fixed again on gold January 31, 1934. When the Belgian currency was devalued by a definitive amount in March, 1935, the response was immediate and pronounced. In both cases the new standard of value had been more or less permanently established at the time the repatriation of funds took place. In the case of the first French devaluation, on the other hand,—which involved a long period of trial stabilization before final adoption of the parity, — the return of French balances from abroad took place gradually and over many months. Happenings after the departure of the pound sterling from gold in 1931 were still different; by the Spring of 1932 funds again were flowing to London, notwithstanding that sterling was still a fluctuating currency.

Evidently confidence is a highly important factor, and it appears that economic and political conditions in Europe are still too unsettled to attract a general flow of capital, notwithstanding the cuts that have been made in currency values. In any event, this country has ample gold to spare.

Gold Stock at New Peak

Additions to the monetary gold stock during the month aggregated $186,000,000, representing $176,000,000 actual imports, plus small releases from earmarking and purchases from domestic production, minus the $10,000,000 added to earmark, as noted above.

Of this gold, about $94,000,000 came from France during the first seven days, representing the conclusion of transfers contracted for prior to the devaluation of the franc. From England we received about $52,000,000, with $26,000,000 more to come.

Considerable significance attaches to the inflow from London, in that this gold is said to represent in part at least dehoarded metal that has come to light since the Gold Bloc devaluation and formation of the tripartite stabilization agreement. Whether this movement will continue remains to be seen. It is, however, suggestive of further possible gains to bank reserves from this source, as the amount of gold in private hoards awaiting return of more settled conditions is known to be very large.

The October gains in gold bring the total net imports for the year to date to $863,000,000, and since the devaluation of the dollar to $3,739,000,000. During the past month, for the first time, the gold stock crossed eleven billions, and now amounts to half the monetary stock of the world.

Trends in Foreign Markets

Continental security markets have had a considerable rise over the past month, as prices have adjusted themselves to the lowered value of the currencies. The increases, naturally, have been most pronounced in stocks, but bonds, too, have risen—evidence principally of reduced monetary strain, since over the long run devaluation is bound to reduce their worth in terms of purchasing power over commodities.

Freed from the obligation to redeem its notes in gold the Bank of France has reduced its rediscount rate to 2 per cent, the lowest since 1931. In Switzerland and Holland the rates are 2 and 2½ per cent respectively, the Swiss rate having been reduced on September 9 and the Dutch rate on October 19. During the past year, in the effort to stem the outflow of gold, the French bank rate has been as high as 6 per cent, and the Dutch rate 4½ per cent.

The lowered value of the former Gold Bloc currencies has permitted greater freedom for the operation of cheap money programs, and the area of low money rates, in consequence, has been extended. In departing from the gold standard, however, it should not be thought that these countries have found a sovereign specific for all ills. The devaluation, of course, had to come, since it appeared to be impracticable to deflate far enough internally to bring costs and prices to a level comparable with those prevailing in depreciated currency countries on all sides. Whether the changes that have been made will succeed in promoting stability and enduring working relationships remains to be seen. On this score the disposition is to be hopeful. (For further discussion of the new currency agreement we refer the reader to the article on "The Recon-

struction of the Gold Standard" on later pages.)

Increasing Bank Loans

A feature of the domestic banking situation has been the expansion of loans classified as "other loans", which excludes loans on securities, loans on real estate and loans to banks. While the make-up of this group cannot be determined precisely, the elimination of the items just mentioned has made this group more generally indicative of commercial borrowing than any other. For this reason the increase now taking place in this category is being followed with especial interest as symptomatic that business gains are at last commencing to affect the need for bank credit.

Since July, the total of "other loans" for the weekly reporting banks, has increased by over $400,000,000, and since a year ago by over $700,000,000. This is a substantial movement, though, of course, the aggregates are still small, compared either with normal levels or with the huge amounts of funds available.

Activity of business is reflected also in an expansion of money in circulation to a point now $600,000,000 greater than a year ago. Notwithstanding the increase in bank loans, and rise of currency outstanding, bank reserves, — owing partly to gold imports, — have increased even more, with the result that "excess" reserves at the close of month amounted to $2,160,000,000, the largest since the advance in reserve requirements last Summer, and but for that change the largest on record.

Bond Market and New Issues

Prices of gilt-edge bonds continued generally steady, with Government bonds within a point of the year's peak. While statements of the reporting banks have indicated a tendency for banks to lighten their investment portfolios, it is evident that bonds sold have been readily absorbed in other quarters.

The volume of new capital issues has held at a high level, with activity still mainly concerned with conversion offerings. However, the volume of new money sought is creeping up, as shown by the figures of the Commercial & Financial Chronicle. In the nine months ended September 30, corporate financing for strictly new capital purposes totalled $778,000,000, compared with only $230,000,000 in the same period a year ago. Indicative of the dimensions of investment demand was the prompt manner in which $150,000,000 of American Telephone & Telegraph Company conversion 3¼ per cent debentures were snapped up at 101, the issue later going to a premium. Other noteworthy indexes of market conditions included the sale by the City of New York of $30,000,000 one to five-year bonds on a record low basis of 1.1176 per cent, and the sale by a syndicate of Pacific Gas & Electric Company first and refunding mortgage 3½s at 102¾, the most favorable terms for the company since the commencement of the refunding program over a year ago.

Except for a shading in the discount basis of new Treasury bills since the end of September, from 0.186 per cent to 0.12 per cent, short term money rates were unchanged.

Pending Argentine Conversion Operations

The announcement last month of plans for the coming conversion of the dollar debt of the Argentine Government is especially noteworthy, not only because it marks the first of the Latin-American countries to undertake regular conversion operations in this market, but because it signalizes the successful conclusion of a long struggle by a country hard hit by the depression to maintain its credit unimpaired.

With the completion of the present program approximately 43 per cent of Argentina's national indebtedness will have been converted to a lower coupon basis. Conversion of the Federal internal debt of 1,600,000,000 pesos was commenced in 1933 and completed in 1934, with a resultant saving of 30,000,000 pesos annually. Also, thanks to its record of punctuality in meeting debt service requirements, the Government has been in a position to take advantage of declining interest rates to make substantial progress in the conversion of that portion of the debt held abroad. Since 1934 approximately £15,000,000 of 5 and 5½ per cent debt outstanding in the British market has been converted into 4½ per cent bonds, accomplishing an annual saving of approximately 19,000,000 pesos, and diminishing somewhat the requirements for foreign exchange. (Within the past month terms of a new sterling loan to refund £2,400,000 outstanding 4 per cent bonds have been announced at a coupon rate of 3½ per cent, the lowest ever carried on Argentine Government external loans.)

Thus, outside of one Spanish peseta loan, the dollar debt is now the only portion of Argentina's national debt bearing more than a 5 per cent coupon. This debt, amounting to about $240,000,000, consisting chiefly of 6 per cent bonds, represents almost one-fifth of the total debt of the Argentine Government. Its conversion to a lower service basis will constitute an important achievement from the standpoint of the budget, as well as diminishing further the foreign exchange needs.

In view of the extensive scope of the operations now contemplated a brief review of Argentine progress over the past few years would seem to be in order.

Onset of the Depression

When the world depression broke in 1929 it found the Argentine economy, like that of

many other predominantly agricultural countries, peculiarly vulnerable to the forces of the crisis. A debtor nation, with relatively little industrial diversification, Argentina was dependent for its development upon a flow of capital from abroad, relying upon the production and export of primary products for servicing its debts and paying for manufactured imports. The world crisis, with its stoppage of foreign lending and heavy fall of prices of foodstuffs and other raw materials, struck at the very basis of this system. Externally, the balance of payments was disrupted, resulting in an acute shortage of foreign exchange,—in turn, impairing the ability to pay for imports, threatening the maintenance of foreign debt service, and forcing the peso off gold as early as 1929. Internally, the fall of prices crippled purchasing power, curtailed business, froze up the banks, and disorganized the public finances. In short, a general state of disorder existed throughout the economic system, inflicting hardship and loss upon all classes.

Remedial Measures

From this condition of widespread confusion Argentina gradually has been emerging. Progress necessarily was slow at first, but has been more rapid lately as the efforts at home have been aided by improvement abroad. In the beginning, one of the most pressing problems to be tackled was that of exchange, to which the new provisional Government addressed itself on coming to power in 1930. For the first two years, 1931 and 1932, however, very little progress could be made, owing to poor crops and steadily declining prices. Despite the inauguration of an exchange control, and notwithstanding the depreciation of the peso, it was impossible to cut down imports fast enough to keep pace with the rapidly falling export proceeds. Determined even in these critical times to maintain the high standing of Argentine credit, the Government adopted the courageous course of shipping gold in order to keep up the service of the foreign debt. Full payment, however, for imports could not be made, with the result that by the end of 1932 frozen foreign balances had accumulated to almost 400,000,000 pesos.

An important step taken at this juncture (early in 1933) was the signing of the Roca-Runciman Agreement with Great Britain which, while essentially a trade treaty, included a provision for the conversion of British frozen peso credits into long-term sterling bonds. Agreements of a somewhat similar nature were concluded with other countries which in most cases combined certain mutual trade concessions together with unfreezing pacts. In the case of the United States, American frozen pesos were exchanged for fifteen-year 2 per cent dollar serial notes but as yet no trade treaty has been consummated. These measures, while highly constructive in that they tended to relieve the pressure upon exchange and permit freer trade, were not enough to remedy the situation. Equilibrium continued to be lacking in the balance of payments, — a condition that tended to be aggravated by the devaluation of the dollar and the further weakening of the pound sterling. Accordingly, the Government in November, 1933, dropped the official quotation of the peso an additional 20 per cent and attached the currency to the pound sterling instead of to the dollar. Simultaneously a new system of import licenses and exchange control was introduced which, with some modification, continues in operation today.

These measures, coupled with a revival in the world demand for Argentine products due to short crops elsewhere and reduction of agricultural surpluses, resulted in a complete reversal of the exchange situation within a year. Compared with an unfavorable balance of payments of about 223,000,000 pesos in 1933, the year 1934 turned in a surplus of about 160,000,000 pesos, as did 1935 also. Moreover, the Government accumulated enough profits from the exchange operations to use them as a kind of stabilization fund. There exists a disparity of less than 10 per cent between the official and the free rate of exchange, and no great fluctuation has taken place in either rate in relation to the pound or the dollar since the Spring of 1935. The present official rate represents a depreciation of about 55 per cent since 1929.

Fiscal and Banking Reforms

Simultaneously with an exchange problem the Government had to deal also with a budgetary problem brought on by the shrinkage in revenues caused by the depression. Here it is of interest to note that the policy of "priming the pump," held elsewhere so indispensable to recovery, has found no imitators in the Argentine. While budgetary equilibrium could not, of course, be achieved immediately, there has been no extensive Government spending, the Administration making a determined effort to keep outgo within income. Thus it happened that at the end of 1935 the National direct debt was about the same as in 1930. With the improvement in revenues resulting from increased business turnover, the year 1935 showed a small budget surplus which was applied to the floating debt, and this year another small excess of income is in view. In the new budget for 1937 that has just been approved by the Argentine Congress the income tax exemptions have been raised because of anticipated higher customs revenues.

We have referred previously to the Government's resolution in the matter of keeping faith with its creditors, and to its success in converting its internal debt and the sterling debt. The

Government also has carried through extensive reforms of the banking system, including the establishment of a new Central Bank. In revaluing the gold stock of the Bank in May, 1935, there was realized a profit of about 700,000,000 pesos, which was used to repay Treasury bills and to provide working capital for the Institute for Liquidation of Bank Investments, an organization to take over the frozen assets from the banks. As a result, the banks have become exceptionally liquid and interest rates have moved downward.

Nor has the National Government stopped at putting its own house in order. It has also extended its reforms to the provincial finances. Of outstanding importance in this direction was the passage last year of a law unifying and centralizing the tax collections and removing interstate customs tariffs which handicapped internal trade.

Another provision of the Tax Unification Law empowered the National Government to take over the provincial debt. Aided by the rising revenues, the Treasury already has been able to carry out the conversion of the internal indebtedness of several provinces which had borne very high interest rates. All this is paving the way for the intervention in the near future on the part of the National Government in the matter of the provincial and municipal external debt. With the exception of the City of Buenos Aires, the history of this indebtedness during the depression has been far from satisfactory, having been marred by forced conversions and defaults.

Agricultural and Industrial Diversification

Thanks to a policy of encouraging full utilization of natural resources, Argentina is probably today one of the lowest cost producers of agricultural products. There was no attempt to keep down the expansive forces of a vigorous young economy. There was no crop restriction. The acreage actually expanded, and sowing of corn, particularly, increased, enabling Argentina to fill at good prices the gap in supplies wrought by the drought in this country. While the Government has aided wheat and linseed producers by establishing minimum prices, the policy has been to sell freely on world markets, thus avoiding the accumulation of stocks that proved so burdensome in the United States and Canada.

In general, Argentine agriculture learned during the depression to better utilize the wide climatic and soil differences of the country. The alfalfa acreage is now almost twice as large as that of wheat; dairying and fruit growing have been encouraged, while cotton and tobacco are now satisfying a larger proportion of the domestic market.

The protection afforded by peso depreciation and the various import restricting schemes has been a great boon to Argentine industry. According to the census taken last year, the number of workers engaged in manufacturing is now nearly twice the number engaged in agriculture. Cotton spinning, using almost entirely the home grown material, expanded five-fold since 1930. A substantial part of the paper, and almost all of the entire automobile tire and cement needs, are now supplied by the native industries, while the older foodstuff and leather goods industries are making bid for the market in neighboring countries. The exploitation of oil reserves and of other natural resources has been stimulated. The oil output is now about twice as large as in 1929, and has lessened considerably the country's dependence upon imported fuel for its growing motor vehicle equipment. The construction of an extensive road system, still far from being adequate, and the eagerness for modern housing facilities, are further evidences of the country's decidedly rising standards.

Prospects for Continued Gains

The foregoing review, though necessarily condensed and incomplete, will serve, we believe, to show that not only has Argentina gone far on the road to recovery, but that she has made considerable progress in correcting some of the earlier weaknesses of her economy. With the reforms that have taken place, and the greater diversification of economic activity, the country appears to rest on a more stable footing than before. So long as the market for primary commodities continues strong there seems no reason to anticipate any important setback in the rate of Argentine recovery. While this recovery, undoubtedly, has been helped by the general improvement that has occurred throughout the world, there appears ample warrant for the opinion of the London "Economist" that "a substantial share of the credit must also go, without doubt, to the firm guidance of the President of the Republic and of the successive Ministers of Finance."

Reconstruction of the Gold Standard

We gave last month the substance of the agreement between the Governments of France, the United States and Great Britain by which they have undertaken to control the fluctuations of their currencies in relation to each other, within the narrowest practicable limits. The initiative in this action was taken by the French Government, which, facing the necessity of a second devaluation of its currency, proposed that the three Governments join in a concerted effort to minimize the disturbing effects, and to inaugurate a movement for the "re-establishment of a lasting equilibrium between the various economic systems."

The proposal was well stated in this recognition that the disorder in currency relations

is evidence of even more fundamental disorder in the entire system of economic relations throughout the world. The products and services entering trade are valued to each other through the currencies, and disorders in these obviously affect international trade. Moreover, disorders in industry, trade and prices within each country are communicated through the money exchanges to other countries. The change from peace conditions to war conditions and back to peace conditions caused the most widespread disturbance of economic relations, both domestic and international, that ever was known.

The "various economic systems" referred to by the French proposal are the national systems, each using its own currency, and the "lasting equilibrium" to be re-established between them is best understood by comparing their present relations with those existing before the War.

Services of an International Standard

Before the War, all nations but China had adopted gold as the basis of their monetary systems, which means that their domestic currencies were kept to the value of gold, by regulating their volume and by supplying gold as needed for the settlement of international balances. By reason of their fixed relations to gold, the currencies had fixed relations to each other, thus affording a common basis for prices and financial relations all around the world. Gold moved between these countries in the settlement of balances from time to time, to and from, in accordance with business developments and fluctuations. If gold shipments should be unusually large, interest rates would rise in the debtor country, which would set in motion influences in both debtor and creditor countries, automatically holding the movement in check and restoring the normal equilibrium. Thus gold by holding the currencies together exerted a stabilizing influence upon all economic relationships. Competition existed in commodities and in enterprises, but *no competition between currencies.* There is no reason to doubt that this automatic system would have continued to function indefinitely, if subjected to no influence but that arising from the normal processes of industry and trade.

The War and the resulting expansion of bank credit on a great scale, produced the conditions for the period of business expansion and speculative activity which followed. The usual restraints of the gold standard were to a great extent suspended, and the volume of indebtedness greatly increased; the inflated credit and price structure eventually broke down, causing panic, disorganization and depression around the world.

"Disorganization" means that the various parts of an organization no longer work together normally. Some of the factors of the economic system are more adjustable than others, as illustrated by price fluctuations of all kinds, — including personal compensation in different lines, charges for various services, taxes, interest and principal of indebtedness and other stated obligations. The change of most sweeping importance was that in the relations between the natural products of the primary industries and the products and services of the urban populations, including with the latter, trading, transportation, government, etc. Prices of the former declined heavily and of the latter comparatively little or not at all.

Disruption of Trading Relations

The result was a disruption of trading relations which greatly affected the trade between these parties, on one side by the reduction of prices and on the other by the reduction of sales and employment. The effects were especially marked in the trade between countries producing manufactured goods and those producing raw materials and food. Thus Professor Gustav Cassel, eminent economist of the University of Stockholm, comparing the export prices of Sweden's manufactures with the import prices of agricultural and other primary products, calculated that in March, 1931, finished goods had gained 40 per cent over primary products, and the disparity increased later. He added that a similar disparity existed in domestic trade in all countries, and said: *"The entire world economy has thus been put out of balance."* His statement is supported by the price statistics of all countries. The official Macmillan Report of Great Britain in 1931 gave a similar statement regarding the trade of that country (p. 57).

The long preeminence of Great Britain in world trade, shipping and finance, had made the pound sterling the best known currency in the world, and London the most convenient center for the clearing and settlement of international transactions. The London clearings are similar to those of all the cities of the United States, excepting that no other clearings have included such a volume of international business as that handled in London. British investments brought in a constant stream of income, the London money market afforded ready in-and-out employment for surplus funds, and leading banks of many countries maintained reserves in London.

The flow of this business was so regular that prior to the world crisis of the early '90s the Bank of England operated upon average gold reserves equivalent to about $75,000,000 (old standard). When the Bank left the gold base in 1931 it held about $660,000,000 (old standard) of gold, but in view of its foreign obligations, largely undertaken to maintain the international credit structure, decided that gold payments could not be maintained. At

present its gold holdings equal about $1,200,-000,000 (old standard), in addition to which the Treasury Equilization Fund and private hoards have large holdings. The gains since 1931 have consisted mainly of new gold production and of private hoards from many countries, sent to London as the place where use for it most likely could be found, or as the safest place for hoarding.

Great Britain did not leave the gold base voluntarily. She was dragged off by her relations around the world. Declining prices for the products with which foreign countries were accustomed to buy British goods, pay interest on British loans, pay charges of British shipping and maintain deposits in British banks, soon exhausted the gold resources of those countries, and compelled them first to draw down their foreign balances, and then default on overseas obligations. Under these circumstances London could no longer perform the international functions she had gradually assumed. The international exchanges were utterly disorganized and the volume of trade declined disastrously.

Great Britain adopted the single gold standard in 1816, when reforming her "managed currency" after the wars with Napoleon, and the growth of her foreign relations had much to do with its adoption by other countries. Thus she was the central pillar of the gold standard structure and her departure from it inevitably had far-reaching consequences. The Scandinavian countries and a number of others elected to relate their currencies to the pound sterling rather than to gold, on account of their business relations. A small group in Europe, together with the United States of America, (for a time) still adhered to the gold standard, but its international services as described above of course were greatly impaired.

The remainder of the story may be briefly told. The United States felt the pressure of disrupted trade relations more directly in domestic than in foreign relations; in some respects her position was unlike that of Great Britain, but the day for such comparisons, and for arguments, is passed. She yielded to the conditions described, devaluing the unit dollar by 40.9 per cent, in 1934.

Competition in Currencies

It is a familiar fact that where two countries are competing in international trade, a depreciating currency (falling faster in the foreign exchanges than in domestic buying power) will enable one country to undersell another, and, furthermore, that this influence will gradually permeate all trade, eventually unsettling all relations. It is the most demoralizing of all phases of competition. Competition in economies of production or distribution, to improve the quality or reduce the costs, is an incident of both industrial and social progress, and hence constructive, but currency depreciation as a method of competition is essentially destructive, no real benefit resulting. Once begun, the parties can retaliate until the currencies are worthless, gaining nothing, and so many and such bitter antagonisms are aroused that the very foundations of social order are threatened.

As each additional member of the gold bloc surrendered, the competitive pressure upon the remaining ones increased. Their exports declined, causing trade balances to turn against them, with a consequent loss of gold reserves, a resulting rise of interest rates and restriction of credit, thus lessening enterprise, with unfavorable effects upon employment and all business; moreover, as a remedy for this chain of evils from unbalanced trade, restrictions were imposed upon imports (tariffs and quotas) and, since imports are buying power for foreign customers, this action also restricted exports, thus starting a new cycle of the depressing influences. Also, as part of the chain of consequences, Government revenues were declining, expenditures for unemployment-relief were growing and increasing difficulty was experienced in balancing budgets.

An argument for devaluation was that debts could not be paid without it, and that this was the cause of unemployment; but after debts had been reduced to below the pre-war burden, the demand for further devaluations soon became as imperative as before, showing that some other cause was at work.

It is harder to reduce costs than to raise prices and this in brief is why a policy of general inflation meets with less opposition than a policy of natural adjustments after a period of disorganization, although the former policy only postpones the adjustments, instead of correcting the maladjustments. Opposition is increased when the pressure for readjustments seemingly comes from an overhead authority, as an employer or a Government; hence resistance, resentment and increasing agitation over the class controversies which incite grave antagonisms and recriminations. The theory that the chief (or only) problem is in the relations between Capital and Labor is brought to the fore, and obscures the practical and pressing problem of trade relations. An extreme result of this agitation is seen in Spain.

The Tripartite Agreement

The foregoing describes the background and immediate difficulties which prompted the proposal of the French Government to the Governments of the United States and Great Britain, and the acceptance by them. The proposal was not a surprise. Following immediately the action of the United States in 1934, Czechoslovakia, under the pressure of depre-

ciated currencies in that part of Europe, made her second devaluation from the former Austrian standard, and in March, 1935, Belgium yielded, with the second reduction from the pre-war base. Both of these countries have an industrial development dependent upon foreign trade. The Italian currency was devalued 73 per cent in 1927 but free gold payments were no longer maintained. France had devalued 80 per cent in 1928, but after a brief respite her problems became increasingly difficult.

The situation presented by this French communication was critical. There was danger that others of the Gold Bloc, possibly all, might follow France, thus intensifying competition on the lower lever of standards, and that it might not stop there. With new uncertainties threatening, and no sure basis for future plans, business might be more likely to "wait and see" than to go ahead. Were all currencies destined to go the way of the old German "mark" and Austrian "krone"?

Only one rational decision was possible. The choice was between co-operation and anarchy, for civilized society cannot exist without trade, and trade in volume to support the populations of the present time, and on the scale of present day wants, is dependent upon a highly organized system. The Soviet regime in Russia has recognized this, and enforces its authority strictly.

The tripartite plan has been welcomed in all countries with a sense of relief. The new devaluations bring the currencies nearer together, but actual maladjustments are greater than the currency differences. It is one thing to adjust the currencies on paper and another thing to adjust human relations. It must be kept in mind that the real problem is *"the re-establishment of a lasting equilibrium between the various ecomonic systems."* This pronouncement is from a Government which cannot be accused of representing bankers or other "privileged classes," but it means that all discordant factors must be brought into harmonious relations, allowing a ready interchange of raw materials, finished products, and the goods and services of all kinds that the people obtain from each other.

It does not mean that absolute free trade is necessary between countries, for import tariffs always have existed and business adjusts itself to such regulations if changes are not too many, frequent or violent. The emergency use of such tariffs for protection against the abnormal competitive conditions of recent years has intensified the depression. These tariffs and quotas should be removed, to permit the revival of former trade.

This has been done to some extent by France, Italy, Holland and other countries in connection with acts of devaluations, but apparently for the special purpose of preventing the increase of living costs tending to result from devaluation itself, and not always enough to accomplish that. The end in view should be the re-establishment of pre-war trade relations, to which industrial development had been adjusted.

France, Switzerland and Italy are expecting gains in their tourist business, which has been suffering from the devaluations of other countries, but this will depend upon the final readjustments, including all the effects of their recent action, upon the costs of living to tourists. This business, which is important to those countries, affords a striking example of the harm done by the confusion in the currencies.

All business in the countries named will be aided by a revival of tourist travel, and should co-operate to obtain it. But in all such cases, Governments face the problem of conflicting interests among their own people. Thus for several years, succeeding cabinets in France have been struggling to balance the budget by increasing revenues or reducing expenditures, but have failed because of resistance to everything proposed, from first one group and then another. This year an election gave a clear mandate to "ease up" on the strain, and let matters drift for a time. The new "Popular Front" Government at first declined to admit that another devaluation was necessary, but was forced to revise its views by a series of "sit down" strikes for higher wages and shorter working time. Compromises were arranged, which have resulted in higher living costs, less trade, fewer tourists, more unemployment, and the long apprehended second devaluation.

All Governments accompany acts of devaluation with warnings that prices entering into living costs must not be raised, but if more money is required to produce things it is fair to presume that more must be paid to obtain them. The problem is not whether the general level shall be high or low, but to get all on the same level, where they can trade with each other. This is far more important than that one group's wage-rates shall be higher than another's, for after all what good is a high wage-rate without a job? Governments get into hopeless difficulties in attempting to fix trade relations among their own people. It involves taking sides, and all groups naturally stand up for their "rights"; moreover, relative voting power may have influence with Governments, although not a just basis of economic relations. Moreover, what *are* the proper pay relations between all the industries, professions and services, or even between the several members of a ball team? They must be worked out in daily experience, and always have been, with free bargaining, the Government's part being to maintain order and fair play.

The tripartite agreement undertakes a formidable task, which can be only gradually accomplished. The primary obligation of each Government is to its own people and it must hold their confidence. The policy agreed upon contemplates nothing but an advancement of mutual interests, and all other Governments are invited to join. The policy will do much if it lessens the fluctuations in currency relations, and working continuously, may in time achieve the practical stability of former years, (if peace is maintained). Its success is largely dependent upon understanding and co-operation on the part of the public. It is an emergency policy, to re-establish a system which worked automatically, and for the most part admirably, for a very long time, but was put out of order by war. It can be restored only by intelligent recognition of mutual interests.

A Supplementary Agreement

On October 12 a supplementary agreement between the tripartite powers was announced, which is to the effect that to whatever extent they shall acquire each other's currencies, they may convert them into gold and withdraw the gold from the debtor country. This arrangement evidently was necessary to implement the original agreement, which contemplates that the parties shall use the funds set up for the stabilization of their own currencies. There is no inconsistency in their use to stabilize other currencies in relation to their own, for this means the same thing, but if such funds are permanently locked up in foreign currencies, they will be lost to the owners, which, of course, is beyond the agreement.

This condition plainly indicates the scope and limitations of the agreement. If the available gold reserves of either of the parties shall be exhausted, or so nearly exhausted that the Government shall be unwilling to have further drafts made, the agreement will be ended by the disability of one of the parties. Moreover, this condition recognizes the fundamental principle which governs all exchange relations, to wit: that in the long run the exchanges must settle themselves. However such an agreement may be "implemented" or "supported", it can do no more than smooth out the irregularities in exchange relations. None of these nations would agree to be responsible for the settlement of all adverse balances that might accrue to another nation in its exchange relations. There is no escape from the condition that in the long run the only way large sums can be paid by one country to another is by means of products or services. Disregard of this made the reparations agreement imposed on Germany impracticable, a conclusion finally accepted by the Lausanne Conference. The determination of this Conference is entitled to rank with the tripartite agreement as a frank recognition of economic realities.

The tripartite agreement is a vindication of the pre-war gold standard, which was a product of economic evolution, and did not break down through any defect in principle, but by a vast upheaval in world relations for which it had no responsibility. A common standard of value is a promoter of friendly and mutually helpful relations.

It is a decisive answer to "managed currency" advocates in so far as they propose that their several countries, (each speaking for his own) shall manage its own currency, "without the advice or consent of any other nation on earth." All of that goes by the board; for it is a logical assumption that the co-operation now inaugurated never will be abandoned, but gradually broadened and strengthened for the protection and general direction of a permanent international standard.

A Fixed Standard Ultimately Necessary

Good as the agreement is for the immediate purpose, the ultimate purpose requires something more than an arrangement for a limited co-operation which any country may feel free to abandon under the pressure of internal or temporary conditions. One of the fundamental services rendered by the pre-war international standard was that its operations tended to unify the business world, and thus minimize the influence of disturbing economic developments in any one country. Internal tendencies to credit expansion, or violent price fluctuations, were modified by the international relations, which thus were a stabilizing influence. Such tendencies should conform to the standard of value and to banking policies, rather than having the latter conform to them. Otherwise there can be no control. The reluctance of banking authorities in a single country to take action that may seem to be adverse to rising "prosperity" of the boom time variety is well known, and the closer the banking authorities are to the political government the more pronounced is the tendency.

When the stabilization of currencies in relation to each other, and to gold, has been accomplished, a unified world system will again exist, and we know how that works—barring a World War, which at any time will make an end of monetary stability. But if every country should have a "managed currency" of its own, and in obedience to the pressure of domestic influences break away from the system, the evils of currency competition would quickly reappear.

International co-operation should be maintained for dealing with the larger problems, but year-to-year operations of the unified system should be as largely automatic as possible. For the regulation of these no adequate substitute for the gold standard has been proposed.

The sentence quoted from the proposal of the French Government may be accepted as

meaning that all divisions of French opinion want a "re-establishment of a lasting equilibrium between the various economic systems," *as demonstrated by pre-war experience.*

Also this may be assumed as the meaning of the notable utterance of the Right Honorable Neville Chamberlain, Chancellor of the British Exchequer, in a public address in London following the tripartite agreement. He said:

> I have heard it suggested that the measures taken by various members of the gold bloc mean that we are about to enter upon a new era, a feature of which will be the permanent establishment of a managed currency. I think it very unlikely. I see no reason to alter the view I have expressed before, that ultimately we will probably come back to an international monetary standard on the only basis which appears to give general confidence.

The Soviet Union Government of Russia has long since gotten rid of an early belief that money or gold was an instrument of oppression, and has been steadily building up both its gold production and gold banking reserves to firmly stabilize its currency.

Another consideration bearing upon the theory of independent management of national currencies is apropos of the enormous losses to the thrifty classes of all populations from the currency devaluations. Neither the hardships upon individuals and families nor the effects upon economic stability have been truly appreciated. Excepting the three western Scandinavian countries, Holland and Switzerland, most of the countries of Continental Europe have devalued their currencies by from 80 to 90 per cent and some of them more. All obligations in terms of money were wiped out to a corresponding extent, including the war loans patriotically subscribed by all classes, all savings in the form of mortgages, savings bank deposits, life insurance policies, and similar investments. Moreover, this was done by successive devaluations, each time unsettling the economic structure and affecting the confidence and morale of the people. In addition to the financial loss from this instability, there is the loss in the "will" to work and to save for the future, which is a powerful constructive force in society. A body of loanable funds is an invaluable factor in social progress. To wipe it out or arbitrarily sacrifice any part of it from time to time is not only a grevious wrong but a social calamity.

In the disorder and excitement which always attends upon the collapse of a huge structure of inflated credit and prices, built up by imprudent borrowing and reckless speculation, an outcry always arises against the standard of value, which by a strange illusion is charged with the "instability". In truth the origin of the instability has been in the minds of the persons who were first buying without reason and then selling in a panic. The very function of money is to convey buying power from parties who are wanting to acquire something, to parties who are wanting to sell it, and at prices upon which they have agreed. A monetary system which did not respond to the law of supply and demand would be about as useful as a controlled thermometer which instead of reflecting changes of temperature would maintain uniform readings all the year round.

The Supply of Gold and Influence Upon Credit

Another argument offered against the gold standard was that gold was too scarce—not enough, it was said, to supply the needs of the world. The fall of prices was attributed to lack of gold, instead of to the disruption of trade relations. It is true that the increase of mining costs (due to the War) caused a temporary falling off of gold production, but the additions to gold reserves from gold coin in circulation more than made this good at the time, and with the increase in the mint price of gold by currency devaluations, production has rapidly increased. It has practically doubled since 1929, and will make a large increase this year, the seventh in succession.

All of the important producing countries have increased their output, including Canada, Australia and South Africa, where important ore bodies have been opened, but the largest increase has been made in Russia, now second in rank, as the result of mechanization and improvements in transportation.

Gold production is so large that inequalities of distribution probably will be corrected by the new supplies, rather than by redistribution from present reserves. How long it will take to bring these stocks into actual use depends upon trading relations. The tendency has been for the new production to accumulate in the centers, and it will be distributed only by the spread of business activity.

It is evident that the great increase in gold supplies, plus the increase of reserves resulting from the devaluation of currencies, promises an enlargement of the monetary base and in the superstructure of credit, *on the basis of past reserve regulations and practices.* Such situations always have been a forerunner of a vast increase in the volume of indebtedness, and of speculative excesses with economic instability. They illustrate the class of problems requiring international co-operation.

The National City Bank of New York

Head Office · 55 WALL STREET · *New York*

Seventy-two Branches in Greater New York — Seventy-two Branches in Twenty-three Foreign Countries

Condensed Statement of Condition as of September 30, 1936

INCLUDING DOMESTIC AND FOREIGN BRANCHES

ASSETS

Cash and Due from Banks and Bankers		$ 425,618,074.07
Gold Bullion Held Abroad or in Transit		39,279,499.94
United States Government Obligations (Direct or Fully Guaranteed)		564,098,858.58
State and Municipal Bonds		111,456,907.04
Other Bonds and Securities		109,923,948.03
Loans, Discounts and Bankers' Acceptances		548,225,998.43
Customers' Liability Account of Acceptances		20,784,372.23
Stock in Federal Reserve Bank		3,600,000.00
Ownership of International Banking Corporation		8,000,000.00
Bank Premises		53,241,946.95
Items in Transit with Branches		2,318,786.14
Other Assets		4,398,043.48
Total		$1,890,946,434.89

LIABILITIES

Deposits		$1,705,290,380.61
Liability as Acceptor, Endorser or Maker on Acceptances and Bills	$50,074,492.89	
Less: Own Acceptances in Portfolio	9,232,735.56	40,841,757.33
Reserves for:		
Unearned Discount and Other Unearned Income		3,893,262.79
Interest, Taxes, Other Accrued Expenses, etc.		7,379,694.24
Dividend		1,550,000.00
Capital	$77,500,000.00	
Surplus	42,500,000.00	
Undivided Profits	11,991,339.92	131,991,339.92
Total		$1,890,946,434.89

Figures of Foreign Branches are as of September 25, 1936.

United States Government Obligations and other securities carried at $113,987,182.79 in the foregoing statement are deposited to secure public and trust deposits and for other purposes required by law.

(Member Federal Deposit Insurance Corporation)

City Bank Farmers Trust Company

Head Office : 22 WILLIAM STREET · *New York*

Condensed Statement of Condition as of September 30, 1936

ASSETS

Cash and Due from Banks	$ 32,089,427.71
Loans and Advances	9,176,533.94
United States Government Obligations (Direct or Fully Guaranteed)	26,562,064.44
Other Bonds, Mortgages and Securities	31,826,926.73
Stock in Federal Reserve Bank	600,000.00
Bank Premises	4,465,289.25
Other Assets	2,386,788.17
Total	$107,107,030.24

LIABILITIES

Deposits	$ 82,137,320.06
Reserves	1,575,985.16
Capital	10,000,000.00
Surplus	10,000,000.00
Undivided Profits	3,393,725.02
Total	$107,107,030.24

United States Government Obligations and other securities carried at $1,516,115.58 in the foregoing statement are deposited with public authorities for purposes required by law.

(Member Federal Deposit Insurance Corporation)

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